COMMENTS

of

TAX EXECUTIVES INSTITUTE, INC.

on

REG-130967-13 and REG-134361-12

relating to

Temporary and Proposed Regulations regarding Withholding Under the Foreign Account Tax Compliance Act Provisions of Chapter 4 of the Code and Coordinating such Withholding with Chapters 3 and 61 and Section 3406

submitted to

The Internal Revenue Service

May 5, 2014

I. INTRODUCTION

The Hiring Incentives to Restore Employment Act of 2010 added Chapter 4 to the Internal Revenue Code of 1986 (the Code), as sections 1471 through 1474. These provisions, better known as the Foreign Account Tax Compliance Act (FATCA), require information reporting with respect to certain recipients of certain U.S. source payments. If the information is not reported, Chapter 4 requires the withholding agent to withhold a 30 percent tax on such payments.

Since the enactment of Chapter 4, the IRS and Treasury Department have issued several sets of administrative and regulatory guidance that provide additional details regarding how taxpayers may comply with their FATCA obligations. On February 20, 2014, Treasury and the

IRS released proposed and temporary regulations making certain modifications to the final regulations under Chapter 4.[1] Also on that date, the government released proposed and temporary regulations coordinating the Chapter 4 withholding regime with the preexisting regimes under Chapters 3 and 61, and section 3406.[2] On May 2, 2014, Treasury and the IRS released Notice 2014-33 providing a "transition period" for FATCA enforcement and administration, as well as other relief to taxpayers. Comments were requested on the two sets of proposed and temporary regulations no later than May 5, 2014.

II. BACKGROUND

Tax Executives Institute, Inc., (TEI) is the preeminent association of in-house tax professionals worldwide. Our nearly 7,000 members represent 3,000 of the leading corporations in the United States, Canada, Europe, and Asia. TEI represents a cross-section of the business community, and is dedicated to developing and effectively implementing sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. As a professional association, TEI is firmly committed to maintaining a tax system that works – one that is administrable and with which taxpayers can comply in a cost-efficient manner.

TEI's members are responsible for managing the tax affairs of their companies and must contend daily with the provisions of the tax law relating to the operation of business enterprises, including compliance with FATCA, both in the United States and around the world. We believe that the diversity and professional training of our members enable us to bring a balanced and practical perspective to the issues raised by the proposed and temporary regulations issued under Chapter 4, the related coordinating regulations, and Notice 2014-33.

[1] *See* T.D. 9657, 79 Fed. Reg. 12,812.
[2] *See* T.D. 9658, 79 Fed. Reg. 12,726.

III. TEI COMMENTS

A. Notice 2014-33

Notice 2014-33 provides that "calendar years 2014 and 2015 will be regarded as a transition period for purposes of . . . enforcement and administration with respect to the implementation of FATCA . . . ." The transition period "is intended to facilitate an orderly transition for withholding agent and FFI compliance" under Chapter 4.

The Notice states that the IRS will take into account the extent to which taxpayers with certain withholding and reporting responsibilities under FATCA have made good faith efforts to comply with the requirements of Chapter 4. In addition, a withholding agent or FFI will be allowed to treat an obligation held by an entity (but not an individual) that is "issued, opened, or executed on or after July 1, 2014, and before January 1, 2015, as a preexisting obligation for purposes of implementing the applicable due diligence, withholding, and reporting requirements under chapter 4."

TEI welcomes the transition period and other relief provided by Notice 2014-33 and commends the IRS and Treasury Department for responding to taxpayer comments regarding the practical problems presented by FATCA compliance, especially in the continued absence (as of this writing) of instructions to the final Forms W-8. The relief provided by Notice 2014-33 strikes the proper balance between implementing an effective FATCA withholding regime and the practical challenges taxpayers face in making the necessary systems, process, documentation, and other changes to properly comply with Chapter 4.

B. Issues regarding the Treasury Center and Holding Company Exceptions to the Definition of a Foreign Financial Institution (FFI)

A foreign entity that would otherwise be treated as a financial institution and required to register as a participating FFI may be treated as an excepted nonfinancial group entity, and

therefore a nonfinancial foreign entity (NFFE), if the entity is a treasury center or holding company (as defined).[3] To qualify for these exceptions, however, the entity's expanded affiliated group (EAG) must be a nonfinancial group.[4] To be a nonfinancial group: (i) the EAG must satisfy a passive income and asset test that applies on a group-wide basis; and (ii) any member of the EAG that is an FFI must either be a participating FFI or a deemed-compliant FFI.[5]

A foreign pension plan is also generally an FFI, but can be excepted from FATCA withholding if it meets certain requirements under the regulations[6] or under the provisions of an Intergovernmental Agreement (IGA) entered into by the United States and another country to implement FATCA. The assets of a foreign pension plan can be held in many different ways. If the foreign pension plan assets are held by a trust in which the employer company (*i.e.*, the company whose employees participate in the pension plan) holds no ownership interest, it seems clear that such assets should not be considered when determining whether there is an FFI in the EAG. Similarly, the assets of such a trust should not be included when measuring the passive income and assets of the EAG in the nonfinancial group determination. In some countries, however, an employer company may be considered the owner of the plan assets due to the manner in which the assets are held or the plan is organized. TEI is concerned that inclusion of these assets and plans when testing the EAG's assets may cause the EAG to fail to qualify as a nonfinancial group. The assets may also cause the member of the EAG that owns the assets to be an FFI. Because that FFI would not be a participating or deemed compliant FFI, the group's treasury centers and holding companies would not qualify for those exceptions to FFI status.

---

3 *See* Treas. Reg. § 1.1471-5(e)(5)(i)(A)(*2*).
4 *See* Treas. Reg. § 1.1471-5(e)(5)(i)(A).
5 *See* Treas. Reg. §§ 1.1471-5T(e)(5)(i)(B)(*1*) and 1.1471-5(e)(5)(i)(B)(*2*).
6 *See* Treas. Reg. § 1.1471-6(f).

Whether an employer entity is an FFI and whether an EAG is a nonfinancial group should not depend on the manner in which a foreign pension plan's assets are held. TEI recommends that the regulations provide that assets of a foreign pension plan be excluded from the determination of whether an employer entity is an FFI and whether an EAG is a nonfinancial group.

One of the activities treasury centers are permitted to engage in is cash pooling, which is described as "[m]anaging the working capital of the expanded affiliated group (or any member thereof) such as by pooling the cash balances of affiliates (including both positive and deficit cash balances) or by investing or trading in financial assets solely for the account and risk of such entity or any member of its expanded affiliated group . . . ."[7] Treas. Reg. § 1.1471-5(e)(1) defines a financial institution to include an entity that "[h]olds, as a substantial portion of its business . . . financial assets for the benefit of one or more other persons (custodial institution) . . . ." An entity that pools the cash of its EAG may also be considered to hold financial assets for the benefit of other persons. Thus, while an entity that engages in cash pooling that also constitutes holding assets for the benefit of others should satisfy the exception to FFI status for treasury centers and not be treated as a custodial institution, it is not entirely clear. The IRS should clarify that an entity engaged in cash pooling qualifies for the treasury center exception and is treated as an excepted nonfinancial group entity even where the cash pooling activities might cause the treasury center to be a custodial institution.

C. Exceptions to the Definition of Withholdable Payments with respect to Pre-existing Obligations and Other Payments – Due Diligence Requirements

The due diligence requirements to support a withholding agent's determination that Chapter 4 withholding is not required because of the nature of the payment or the obligation is unclear in many cases. Such payments must be reported to the IRS on Form 1042-S even if not

---

[7] Treas. Reg. § 1.1471-5T(e)(5)(i)(D)(*1*)(*iv*)

subject to withholding. To assist withholding agents in complying with their due diligence obligations, TEI recommends that the IRS clarify the steps or actions necessary to support a determination that FATCA withholding is not required for each situation described below and for similarly unclear situations.

Chapter 4 subjects certain payments of U.S. source fixed and determinable annual and periodical (FDAP) income to a 30 percent withholding tax unless certain information is reported to the IRS or an exception applies.[8] One exception is for excluded nonfinancial payments (*e.g.*, royalties and payments for services).[9] Such payments must still be reported to the IRS even if not subject to withholding. For example, the 2014 Form 1042-S includes a Chapter 4 exemption code for an "Excluded nonfinancial payment." In addition, withholding under Chapter 4 does not begin until July 1, 2016, for preexisting obligations.[10] Guidance is needed to clarify the due diligence requirements for determining that an amount paid to an NFFE is grandfathered pursuant to a preexisting obligation. Is a W-8 that expires after December 31, 2013 sufficient?

Preexisting obligations giving rise to financial payments (*e.g.*, dividends and interest, insurance premiums, broker fees) must also be reported even if not subject to withholding.[11] What due diligence is required to determine that a financial payment is grandfathered? Is a W-8 that expires after December 31, 2013 sufficient?

Finally, what type of documentation is required to support the exception to FATCA reporting on July 1, 2014 (or January 1, 2015 for obligations held by entities), for nonfinancial payments that are not related to pre-existing obligations? If a new contract with a prior vendor is executed on or after July 1, 2014 (or January 1, 2015) and there is a pre-FATCA W-8BEN for

---

[8] 26 U.S.C. Sec. 1471.

[9] Treas. Reg. § 1.1473-1(a)(4)(iii).

[10] Treas. Reg. § 1.1471-2T(a)(4)(ii).

[11] See the Chapter 4 exemption code on 2014 Form 1042-S for a "grandfathered payment."

that vendor, does a post-FATCA W-8BEN need to be completed? Is a W-8 sufficient? Or will other documentation need to be completed? Clear answers to all these questions would facilitate taxpayer compliance with FATCA.

D. Indemnity Payments

Many taxpayers, especially multi-national companies, make indemnity payments. Such amounts may be paid on self-insured obligations or when acting as a third party administrator for indemnity payments made on behalf of another company. In each case the multi-national company or third-party administrator must comply with FATCA. Indemnity payments are typically not taxable to the recipient and thus should not generally be considered a withholdable payment for FATCA purposes. Such payments are not listed as an "excluded nonfinancial payment" in Treas. Reg. § 1.1473-1(a)(4)(iii), which may lead to an inference that indemnity payments are withholdable payments. To ensure that these payments are not treated as withholdable payments, TEI recommends that the following phrase be added to the definition of excluded nonfinancial payment: "amounts paid either by a company or an agent acting on behalf of a company for indemnity claims whether or not covered by insurance from an unrelated party . . . ."

E. Changing FATCA Status and Definition of a Nonfinancial Group

Under Chapter 4, foreign entities and groups may move from one FATCA status or categorization to another in many circumstances. For example, entities may move into and out of an EAG if the ownership level varies near 50 percent. Alternatively, entities may move between different EAGs where there are two principal owners and each owns close to 50 percent. Similar issues arise from mergers and acquisitions of entities or groups. The IRS should provide a grace period for an entity or group to test its FATCA status and adjust its FATCA compliance processes if its status under the regulations changes.

A particularly critical example of this kind of change arises when determining whether an EAG meets the requirements to be treated as a nonfinancial group. To qualify as a nonfinancial group, the passive income earned by an EAG over a three-year period must fall below certain thresholds. In addition, the EAG must hold no more than a certain percentage of passive assets.[12] If an EAG fails the threshold requirements, then it is no longer a nonfinancial group, and it must take additional steps to comply with FATCA. For example, the EAG's treasury centers and holding companies would no longer be excluded from the definition of an FFI, and they may have to register with the IRS to avoid withholding under Chapter 4.

The regulations do not afford a grace period to permit EAGs to become FATCA-compliant. That is, if an EAG is no longer a nonfinancial group because it fails, for example, the three-year passive income test, then payments to the EAG's treasury centers and holding companies would be immediately subject to withholding under Chapter 4 beginning on January 1 of the year in which it is determined the EAG no longer satisfies the test. It would not be unusual, however, for an EAG to qualify as a nonfinancial group in one year but to fail to satisfy the passive income and asset test in other years. For example, an EAG that sold a business line could have a substantial amount of cash on hand at year-end that is in excess of 25 percent of the EAG's assets. In such circumstances, it would be extremely difficult for the EAG to timely comply with the FATCA reporting requirements.

TEI recommends that (i) EAGs be given time to determine whether they satisfy the three-year nonfinancial group tests for passive income and assets in the following year, and (ii) if an EAG determines that it has failed the test for nonfinancial group status, it be given time to become FATCA-compliant by, for example, registering its treasury centers and holding companies with the IRS as participating FFIs. For example, an EAG could be required to

---

[12] *See* Treas. Reg. § 1.1471-5T(e)(5)(i)(B)(*1*).

determine whether it is a nonfinancial group within 90 days of its year end and, if it fails the nonfinancial group test, the EAG should be given at least 90 days to become FATCA-compliant before withholding begins.

F. Interaction of the Regulations and IGAs

The current regulations do not include a detailed explanation of how the final FATCA and coordinating regulations are to be applied if an IGA (whether model 1 or model 2) is in place with another jurisdiction. This leaves many unanswered questions about how taxpayers may comply with the regulations in jurisdictions that have executed IGAs.

For example, a number of IGAs define an FFI in a different manner than the Treasury regulations. If an IGA's definition of an FFI does not encompass holding companies or treasury centers, would those companies not need to meet the exception from FFI status provided in Treas. Reg. § 1.1471-5(e)(5)? Alternatively, if an exception to FFI status is narrower under an IGA than under the regulations, which definition controls? Can the taxpayer choose the more favorable definition? TEI's members are also aware of instances where IGA countries have demanded that a taxpayer's treasury center register with the IRS as a participating FFI when the center clearly meets the exception to FFI status under the regulations. What should a taxpayer do in this case? TEI recommends the IRS assess the interaction between the regulations and IGAs to answer these questions and others that may arise when applying the two sets of rules.

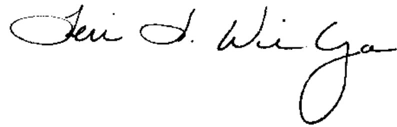
IV. CONCLUSION

Tax Executives Institute appreciates the opportunity to offer its views on the recently released proposed and temporary regulations modifying the final regulations under Chapter 4 and coordinating Chapter 4 withholding with Chapters 3 and 61 and section 3406 of the Code. Please do not hesitate to contact Ernest N. Gates, Chair, TEI IRS Administrative Affairs

Committee, Ernest.Gates@walmartlegal.com, or Benjamin R. Shreck, TEI Tax Counsel, at 202.638.5601 or bshreck@tei.org, should you have any additional questions.

Respectfully submitted,

TAX EXECUTIVES INSTITUTE, INC.



By:

Terilea J. Wielenga
TEI International President